

# [COMMITTEE PRINT]

MAY 12, 2004

**SHOWING THE TEXT OF H.R. 3574,**

**AS REPORTED BY THE SUBCOMMITTEE ON CAPITAL MARKETS,  
INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES**

**1 SECTION 1. SHORT TITLE.**

2       This Act may be cited as the “Stock Option Account-  
3 ing Reform Act”.

**4 SEC. 2. MANDATORY EXPENSING OF STOCK OPTIONS HELD  
5 BY HIGHLY COMPENSATED OFFICERS.**

6       Section 13 of the Securities Exchange Act of 1934  
7 (15 U.S.C. 78m) is amended by adding at the end the  
8 following:

9       “(m) MANDATORY EXPENSING OF STOCK OP-  
10 TIONS.—

11       “(1) NAMED EXECUTIVE OFFICER.—As used in  
12 this subsection, the term ‘named executive officer’  
13 means—

14       “(A) all individuals serving as the chief ex-  
15 ecutive officer of an issuer, or acting in a simi-  
16 lar capacity, during the most recent fiscal year,  
17 regardless of compensation level; and

18       “(B) the 4 most highly compensated execu-  
19 tive officers, other than an individual identified



1 under subparagraph (A), that were serving as  
2 executive officers of an issuer at the end of the  
3 most recent fiscal year.

4 “(2) IN GENERAL.—Subject to paragraph (4),  
5 every issuer of a security registered pursuant to sec-  
6 tion 12 shall show as an expense in the annual re-  
7 port of such issuer filed under subsection (a)(2), the  
8 fair value of all options to purchase the stock of the  
9 issuer granted after December 31, 2004, to a named  
10 executive officer of the issuer.

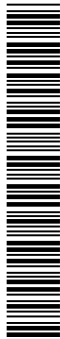
11 “(3) FAIR VALUE.—

12 “(A) IN GENERAL.—The fair value of an  
13 option to purchase the stock of the issuer that  
14 is subject to paragraph (2) shall be—

15 “(i) equal to the value that would be  
16 agreed upon by a willing buyer and seller  
17 of such option, who are not under any  
18 compulsion to buy or sell such option; and

19 “(ii) shall take into account all of the  
20 characteristics and restrictions imposed  
21 upon the option.

22 “(B) PRICING MODEL.—To the extent that  
23 an option pricing model, such as the Black-  
24 Scholes method or a binomial model, is used to  
25 determine the fair value of an option, the as-



1           sumed volatility of the underlying stock shall be  
2           zero.

3           “(4) EXEMPTIONS.—

4                 “(A) SMALL BUSINESS ISSUERS.—This  
5           subsection shall not apply to an issuer, if—

6                 “(i) the issuer has annual revenues of  
7                 less than \$25,000,000;

8                 “(ii) the issuer is organized under the  
9                 laws of the United States, Canada, or Mex-  
10                ico;

11                “(iii) the issuer is not an investment  
12                company (as such term is defined under  
13                section 3 of the Investment Company Act  
14                of 1940 (15 U.S.C. 80a-3));

15                “(iv) the aggregate value of the out-  
16                standing voting and non-voting common  
17                equity securities of the issuer held by non-  
18                affiliated parties is less than \$25,000,000;  
19                and

20                “(v) in the case of an issuer that  
21                meets the criteria in clauses (i) through  
22                (iv) and is a majority owned subsidiary,  
23                the parent of the issuer meets the require-  
24                ments of this paragraph.



1           “(B) DELAYED EFFECTIVENESS.—The re-  
2           quirements of this subsection shall not apply to  
3           an issuer before the end of the 3-year period  
4           beginning on the date of the completion of the  
5           initial public offering of the securities of the  
6           issuer, and shall only apply to an option to pur-  
7           chase the stock of an issuer granted after such  
8           date.”.

9   **SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IM-**  
10           **PACT STUDY.**

11       (a) PROHIBITION.—Section 19(b) of the Securities  
12   Act of 1933 is amended by adding at the end the fol-  
13   lowing:

14           “(3) PROHIBITION ON EXPENSING STAND-  
15   ARDS.—

16           “(A) IN GENERAL.—The Commission shall  
17           not recognize as ‘generally accepted’ any ac-  
18           counting principle relating to the expensing of  
19           stock options unless—

20                   “(i) it complies with the requirements  
21                   of subparagraph (B); and

22                   “(ii) the economic impact study re-  
23                   quired under section 3(b) of the Stock Op-  
24                   tion Accounting Reform Act of 2003 has  
25                   been completed.

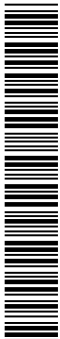


1           “(B) REQUIREMENTS.—A standard re-  
2           ferred to in subparagraph (A) shall require  
3           that—

4                   “(i) if an option to purchase the stock  
5                   of an issuer that is subject to the require-  
6                   ments of section 13(m) of the Securities  
7                   Exchange Act of 1934 is exercised—

8                           “(I) any expense that had been  
9                           reported under that section 13(m)  
10                          with respect to such option shall be  
11                          recomputed as of the date of exercise  
12                          and shall be equal to the difference  
13                          between the price of the underlying  
14                          stock and the exercise price; and

15                           “(II) to the extent the recom-  
16                           puted amount differs from the  
17                           amount previously reported under sec-  
18                           tion 13(m) with respect to such op-  
19                           tion, the difference shall be reported  
20                           in the fiscal year in which the option  
21                           is exercised as a reduction or increase,  
22                           as the case may be, of the total ex-  
23                           pense required to be reported under  
24                           that section 13(m) during that fiscal  
25                           year;

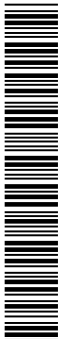


1                   “(ii) if an option to purchase the  
2                   stock of an issuer that is subject to the re-  
3                   quirements of section 13(m) of the Securi-  
4                   ties Exchange Act of 1934 is forfeited or  
5                   expires unexercised, any expense that had  
6                   been reported under that section 13(m)  
7                   with respect to such option shall be re-  
8                   ported in the fiscal year in which the op-  
9                   tion expires or is forfeited as a reduction  
10                  of the total expense required to be reported  
11                  under that section 13(m) during that fiscal  
12                  year; and

13                  “(iii) to the extent that any reduction  
14                  required under clause (i) or (ii) exceeds  
15                  total option expenses for any fiscal year,  
16                  such excess shall be reported as income  
17                  with respect to options to purchase the  
18                  stock of the issuer.”.

19                  (b) ECONOMIC IMPACT STUDY.—The Secretary of  
20                  Commerce and the Secretary of Labor shall conduct and  
21                  complete a joint study on the economic impact of the man-  
22                  datory expensing of all employee stock options, including  
23                  the impact upon—

24                         (1) the use of broad-based stock option plans in  
25                         expanding employee corporate ownership to workers



1 at a wide range of income levels, with particular  
2 focus upon non-executive employees;

3 (2) the role of such plans in the recruitment  
4 and retention of skilled workers;

5 (3) the role of such plans in stimulating re-  
6 search and innovation;

7 (4) the effect of such plans in stimulating the  
8 economic growth of the United States; and

9 (5) the role of such plans in strengthening the  
10 international competitiveness of businesses organized  
11 under the laws of the United States.

